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ABSTRACT

From the earliest times when commodities such as tobacco and beaver pelts were used as money, to the present when credit and debit cards are commonplace, money has played a central role in the U.S. experience. This booklet provides an historical overview of the concept of money as it has evolved in the United States. The booklet is divided into the following sections: "The Beginnings...and Beyond"; "The Constitution and Money"; "Fear of Paper"; "The U.S. Mint"; "Bank of the United States"; "Second Bank of the United States"; "The Free Banking Period"; "National Currency and National Banks"; "National Currency and the Constitution"; "A Return to Gold..."; "And Maybe Silver..."; "...But Finally Gold"; "Federal Reserve and Elastic Currency"; "The Break with Gold"; and "The Story Continues...." Included with the booklet is a teaching guide that contains content questions and answers and activity suggestions. (BT)

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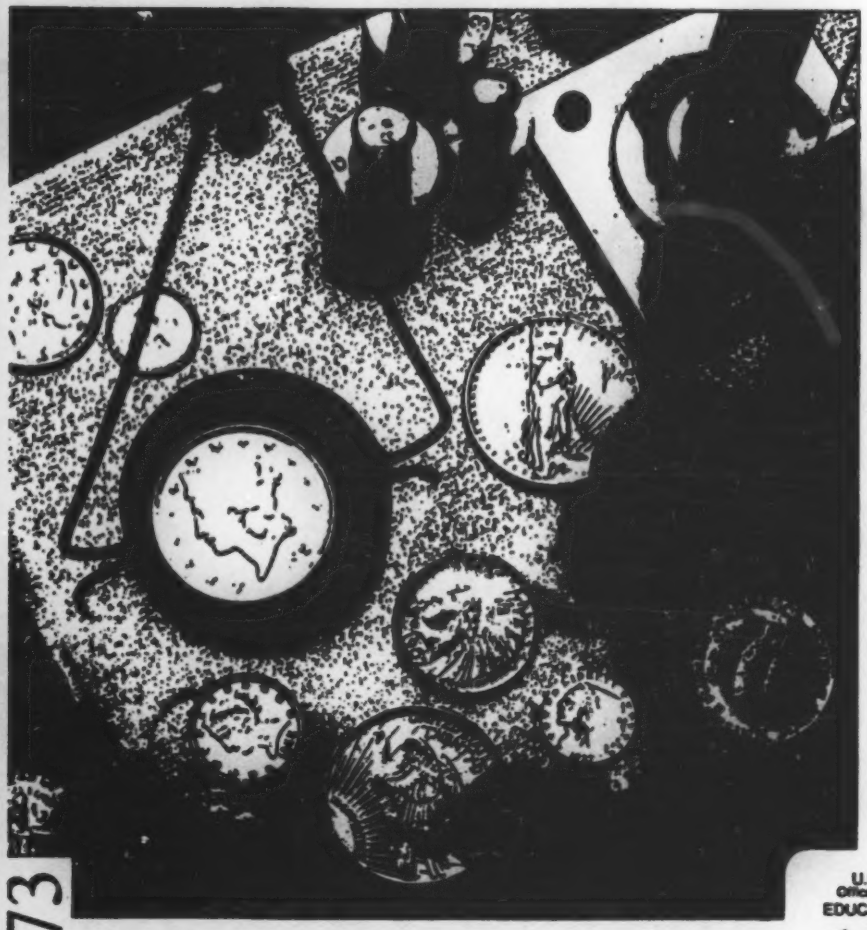
Money Matters

The American Experience with Money



- Is our money backed by gold?
- Does our Constitution authorize national currency?
- Why does the Fed issue currency?

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Money Matters

The Beginnings... and Beyond

From the earliest times when commodities such as tobacco and beaver pelts were used as money, to the present when credit and debit cards are commonplace, money has always played a central role in the American experience.

Early in our history, our monetary system consisted of numerous foreign coins and paper currencies issued by the thirteen colonies and the Continental Congress. More than two hundred years later, we now have a single national currency and privately owned banks chartered by state and federal governments. Furthermore, a central bank, the Federal Reserve, has replaced gold as the regulator of the value of our money.

The evolution from a decentralized system to a more centralized system has been marked by controversy and slowed by a general suspicion of banking power. Each change has involved extensive legal debate focusing on the rights of state and federal governments and the freedom of the individual.

Another important dimension of our nation's economic development is the role of gold. Once a cornerstone of the financial system, gold has gradually but perceptibly become less important, both as a medium of exchange and as a regulator of the money supply. This process was driven by the nature of gold itself as well as by the changing needs of our modern and complex economy.

The Constitution and Money

The framers of the Constitution were apparently undecided about the form of financial system they should establish. Some preferred a centralized system with most of the power residing in the federal government. These framers wanted a national currency and a single federally chartered bank with branches throughout the country.

Others involved in developing the Constitution envisioned a decentralized financial system with principal authority resting in the states. They preferred that each state charter its own banks, and each bank issue its own bank notes—that is, its own paper currency. There would be no uniform national currency and no central bank.

After long debate, the framers of the Constitution permitted the federal government "to coin money, (and) regulate the value thereof and of foreign coins . . ." They also declared that "no state shall . . . coin money, [nor] emit bills of credit [i.e., paper currency] . . ." Significantly, no mention was made of a national currency nor federally chartered banks.

The Constitution specified little involvement for the federal government in our financial system. Congress was expressly permitted only the right to mint metal coins, regulate the percentage of precious metal in those coins, and determine the metallic content of the many kinds of foreign coins that circulated throughout the states. In other words, Congress' involvement in the financial system focused on the intrinsic value of coins, which was determined by the amount of precious metal in the coin.

Fear of Paper

Many of the framers of the Constitution opposed paper money largely because of their experience during the Revolutionary War. In 1775 the Continental Congress faced the problem of fighting a war without the means to pay for it. The British blockade of our ports limited trade, reducing revenues from tariffs, and European nations were reluctant to lend us money. Left with little alternative, the Continental Congress authorized

$2 million of Continental currency. This was the first of many issuances. In total, between 1775 and the adoption of the Constitution in 1787, Congress authorized the printing of about $242 million in "Continentals."

Congress promised to pay the holders of the currency the face value of the bills in gold or silver or in Spanish coins, widely circulated at the time. However, Congress did not have enough gold or silver to make payment. In reality, there was no "backing" for the Continentals; that is, there was no mechanism, except the authority of the Continental Congress, to fix the value of Continentals or to limit the amount that could be issued. As a result, Congress issued more Continentals than the economy could handle without inflation.

This $5 Continental bill was worth only 5¢ when it was redeemed in 1790.

The colonies experienced a rapid increase in inflation as the government printed money without restraint. The resulting oversupply of money undermined the purchasing power, and therefore value, of the Continentals.

To support the faltering currency, Congress declared that any person convicted of refusing Continentals at face value was an enemy of the country and should be "precluded from all trade . . . with the inhabitants of these colonies."

Despite such efforts to maintain the Continental's value, people paying in these notes were charged more than people paying with foreign coin of gold and silver. In other words, Continentals were discounted.

Although the printing of Continentals was an emergency measure that helped to win the war, this episode illustrated the perils of issuing too much currency.

Eventually, in 1790, Congress began redeeming the currency at a rate of 100 Continentals to the dollar measured in Spanish coins, which contained gold and silver. By using gold and silver as currency, the

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founding fathers sought to maintain the value of money by limiting the amount in the economy. The upper limit was set by the amount of gold and silver that could be produced domestically or acquired from other nations. There was no such upper limit under the "paper standard" of Continental currency.

To set this limit, the founding fathers could have used any commodity with the desirable properties of money. Gold and silver were good choices because they were durable; easy to recognize, store, move, divide and standardize; and, most importantly, relatively scarce.

The U.S. Mint

As the U.S. moved away from paper currency, Congress passed the Coinage Act in 1792, ordering Alexander Hamilton, the first Secretary of the Treasury, to establish the U.S. Mint. The Mint cast coins free of charge from gold or silver brought in by individuals. The ratio of silver to gold was fixed at 15 to 1, reflecting their relative values at the time. In other words, 15 silver coins could be exchanged for 1 gold coin. Most coins were fullbodied, meaning their intrinsic value was equal to their face value.

This was our first attempt to adopt by law a bimetallic standard in which both gold and silver were declared legal tender. Free and unlimited coinage of both metals was allowed. Unfortunately, this bimetallic standard for determining the value of money was difficult, if not impossible, to maintain.

The market price of silver began to fall, and it became apparent that fixing the intrinsic value of coins was not something done once, for all time. Because the value of the silver in a coin no longer equalled the coin's face value, the 15 to 1 ratio no longer reflected a balance among the two metals. People sought to exchange silver coins for gold coins. The value of the gold in the coins increased in relation to the face value of the coins. People began hoarding gold coins for their gold content rather than circulating them at face value.

In fact, until 1834 gold tended to leave the country principally because it was valued at a higher rate in France and England than it was here. In an attempt to

slow or stop this outflow of gold, the Mint in 1834 changed the ratio of silver to gold to 16 to 1. This change overvalued gold and caused a return flow to the United States. Silver coins in turn tended to stop circulating.

Thus the intrinsic worth of gold and silver actually restricted their ability to act as a medium of exchange since people frequently tended to hoard them rather than circulate them.

Bank of the United States

While most agreed that Congress should not authorize paper money, there was a significant controversy about Congress' right to charter a bank that could issue its own bank notes.

Thomas Jefferson and Alexander Hamilton represented the opposing viewpoints. Jefferson felt that only states could charter banks. Because the Constitution did not expressly grant the power to Congress, he reasoned that federally chartered banks were unconstitutional.

Hamilton, however, felt that federally chartered banks were not only constitutional but also necessary. He reasoned that since the Constitution established a government, it granted that government the right to establish institutions necessary for its operation.

Thomas Jefferson (left) and Alexander Hamilton (center) disagreed on the proper role of the federal government in the financial system. Jefferson favored a more decentralized government and believed that only states could charter banks under the Constitution. Hamilton felt that the federal government had the power to charter banks because the Constitution granted the government the right to establish institutions necessary for its operations. In a far-reaching decision, Supreme Court Chief Justice John Marshall (right) followed Hamilton's reasoning and ruled in McCulloch vs Maryland ***that the Second Bank of the United States was constitutional.***

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Although these two leaders raised the issue, the constitutionality of federally chartered banks was not resolved at that time. Without determining constitutionality, Hamilton convinced Congress and President Washington in 1791 to establish the Bank of the United States with a twenty-year charter.

The Bank is now referred to as the first central bank in the United States principally because of its national scope and services to the federal government. However, it did little to affect the total supply of money in the economy, as a modern central bank would do. The Bank did aid the government in obtaining emergency loans, facilitated the payment of taxes, and served as receiver and disburser of public funds. In addition, it issued bank notes and made them fully redeemable in coin.

The Bank was a commercial success and provided financial stability. However, in 1811 Congress did not renew the charter chiefly because of the question of the Bank's constitutionality. Once again, as in 1791 when the Bank was chartered, no constitutional test was brought before the Supreme Court.

Second Bank of the United States

In 1812 the nation was at war with the British, and again without a national bank to help finance it. This time, as an emergency measure, the Treasury issued a small number of interest-bearing notes, which were retired soon after the war.

The problems of financing the war, the inflation as a result of the war, and the varying values of the many state bank notes, combined to change Congressional sentiment about a federally chartered bank. In 1816 Congress approved the charter of the Second Bank of the United States, larger in assets than the First Bank and, as it turned out, more controversial.

After some initial years of difficulty the Second Bank helped bring about financial stability and economic prosperity. Like the First Bank, it issued nationally uniform paper currency, redeemable for coin.

The Second Bank, however, is remembered more for its legal and political difficulties than for its financial successes. To promote the soundness of the financial

system, the Second Bank required that all state-chartered banks redeem their notes for an equal value in gold or silver coins. The measure was made in an effort to prevent the overissuance of notes and the resulting devaluation.

Many state-chartered banks, however, did overissue currency. To meet the Second Bank's requirements, they had to reduce the amount of their paper notes outstanding. Many states felt the Second Bank was usurping their constitutional authority. Resentment spread until Maryland and Ohio retaliated by taxing local branches of the Second Bank. The resulting case, *McCulloch vs. Maryland*, was brought before the U.S. Supreme Court in 1819. This case became the first test of the constitutionality of federally chartered banks and nationally issued paper currency.

In one of its most important cases, the Supreme Court unanimously decided that the Bank and its currency were constitutional and that the state tax was unconstitutional. Following Hamilton's rather than Jefferson's reasoning, Chief Justice John Marshall's far-reaching decision stated that the Constitution granted the federal government the powers "necessary and proper" for carrying out its operations, unless the power was clearly withheld by the Constitution.

A landmark decision, *McCulloch vs. Maryland* created the doctrine of "implied powers" that has become the cornerstone of American constitutional law. The decision became the legal safeguard not only for the Second Bank of the United States and its notes, but also for paper money later issued by Congress.

Despite its financial success and legal support, however, Congress did not renew the Bank's charter. Two factors led to the Bank's demise. In 1832 the directors of the Bank made some politically unwise loans to members of Congress. In addition, President Andrew Jackson, a Westerner, distrusted the Eastern monied class, symbolized in his eyes by the Second Bank. The combination of the loans and Jackson's attitudes helped make the Bank a political issue in the presidential election of 1832.

With Jackson's reelection, the fate of the Bank was sealed. Jackson vetoed the bill to renew the Bank's charter, and Congress could not override the veto. In 1833

the federal government removed all deposits from the Bank. In 1836 when the Bank's federal charter expired, it was granted a state charter in Pennsylvania but soon went out of business.

The Free Banking Period

With the demise of the Second Bank, states took over principal control of currency and banking, as some of the framers of the Constitution envisioned. Since each state administered its own system according to its own laws, banking standards were uneven throughout the country.

State-chartered banks issued paper money, which was redeemable for gold or silver. This redemptive quality, or backing by gold and silver, set the limit on the amount of notes that could be printed. While many banks did not overissue notes, some issued more paper money than they had gold and silver to back it. As a result, people became suspicious of un-

Among the many notes that circulated during the free banking period was the $50 note from the Republic of Texas.

familiar notes, frequently accepting them only at less than face value. To compound these problems, even the best managed banks tended to discontinue redemption in gold and silver during a crisis. The difficulties were magnified by a dramatic surge in the number of banks, which tripled between 1837 and 1860. At one time, more than 10,000 different bank notes were in circulation.

Despite these problems, people still looked to gold to regulate the money supply. They rejected the possibility of a flexible or discretionary system managed in an intelligent, non-political, non-inflationary

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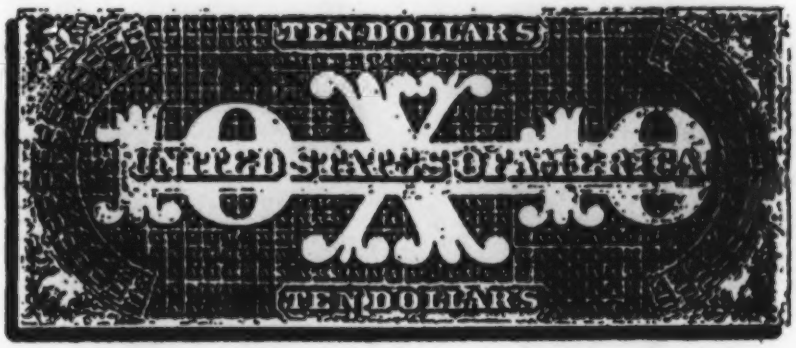
way. Instead, many thought that impersonal, inflexible gold was a flawed, but acceptable alternative. This feeling about gold was confirmed in the minds of many by the Civil War experience with paper currency that could not be redeemed for gold and silver.

National Currency and National Banks

A serious and recurring problem with gold was its inflexibility. When the economy needed more money to finance expenditures, gold coins and gold-backed currency often could not provide the necessary funds. Thus, it is not surprising that we abandoned gold during the Civil War.

When the Confederacy attacked Fort Sumter in 1861, the United States once again found itself at war without a national currency or federally chartered banks to help finance it. Learning from its experience with the First and Second Banks, Congress did not establish a single publicly owned bank that issued its own bank notes. Rather it established a system of federally chartered, privately owned banks and a national currency.

In the early stages of the war the Treasury tried to finance its spending by borrowing money, that is by selling government bonds in exchange for gold and silver. However, it soon became apparent that war spending was far greater than revenues raised from bond sales. In response, the Treasury began paying for purchases by issuing a variety of paper notes, collectively called greenbacks. These paper notes, most of which were not redeemable for gold, became the principal source of financing the war.



The reverse side of the $10 Demand note of 1861 was green, the first greenback of the Civil War.

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Many types of paper currency were issued during this period, including the greenback demand notes, interest-bearing notes, and gold certificates. However, United States notes, first issued in 1862, were historically the most significant. Congress declared the new notes legal tender, meaning they had to be accepted in payment of debt. They were not redeemable for gold or silver coins, as were the First and Second Banks' notes, but were backed by bonds issued by the federal government.

As the government printed more and more notes, the economy experienced a sharp inflation, which pushed the dollar price of gold above its official price. Gold was withdrawn from the nation's banks and hoarded. Once again, the intrinsic value of gold detracted from its ability to circulate.

As a result of this large issuance, the value of a paper dollar decreased to 35 cents in gold. During this period the term "inflation" was used for the first time.

There was soon a cry for a return to gold. Many thought that governments could not be trusted voluntarily to restrain the issuance of money. They felt that our money could only retain its purchasing power if we limited its supply with the nondiscretionary restraint of gold.

National Currency and the Constitution

As the nation struggled with inflation, some questioned whether the federal government had the power to charter banks and issue a national currency. While the new national currency issued by federally chartered banks solved many problems for the government, it added another kind of note for people to carry in addition to the state-chartered bank notes already in circulation. To eliminate these other notes, Congress in 1865 issued a 10 percent tax on state bank notes. These notes soon became too expensive to circulate, and U.S. notes became the dominant medium of exchange.

The question as to whether Congress had the right to impose the so-called death tax on state bank notes was answered in *Veazie Bank vs. Fenno* (1869). The Supreme Court upheld the tax, stating that Congress has the power "to secure a sound and uniform

currency for the country" and "to restrain by suitable enactments the circulation as money of any notes not issued under its own authority."

Eighty years after the adoption of the Constitution and in response to the needs of a growing and struggling country, we acknowledged that the federal government, not state governments, had exclusive power over the country's currency.

This decision did not end the constitutional problems facing a national currency, however. The Court still had to decide the more difficult question about the status of legal tender.

United States notes were issued as an emergency provision to help finance the war, but many, even some in Lincoln's administration, viewed them as unconstitutional. Shortly after the war the question as to whether U.S. notes were legal tender was brought before 17 state supreme courts. In 16 cases those courts found in favor of the legal tender status of U.S. notes. In the other case, *Hepburn vs. Griswold*, the Kentucky Supreme Court decided that U.S. notes could not be considered legal tender. Therefore U.S. notes could not be used to make payment for contracts made before Congress declared these notes legal tender.

If left to stand, this ruling would have significant financial implications. Inflation had increased the intrinsic value of gold and silver coins beyond their face value. As a result, creditors wanted debts repaid in coin, while debtors preferred repaying in depreciated legal tender notes.

The case was appealed before the Supreme Court of the United States in 1867. *Hepburn vs. Griswold* (1870 and 1871) was heard twice before the U.S. Supreme Court under extraordinary circumstances. In 1867 when it was first heard, there were only seven justices rather than the nine allowed by the Constitution. After two years of deliberation and a great deal of emotion, the Court decided by a four to three vote that all contracts made before U.S. notes were declared legal tender were not bound by the legal tender laws. In addition, the opinion implied that all contracts written afterward were not bound by those laws. In effect, the Court said that the notes were not legal tender.

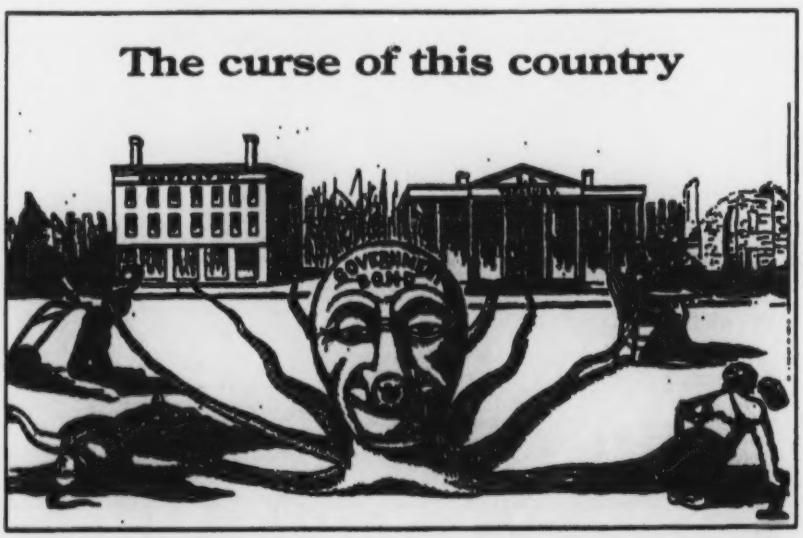
President U.S. Grant, recognizing the implications of this ruling, quickly filled the two remaining Supreme Court justice positions with people who favored legal tender laws. In 1871 *Hepburn vs. Griswold* was reheard. This time by a vote of five to four the Court found legal tender laws constitutional. The ruling was based on the understanding that U.S notes were necessities of warfare. The Court found that a means of self-preservation could not be withheld from a government.

The right of Congress to issue paper currency and declare it legal tender in times of peace was established in *Juilliard vs. Greenman* (1884). Noting that the Constitution granted Congress the right to make all laws necessary and proper for carrying out its powers, the Court ruled Congress has the authority to issue its own currency.

A Return to Gold . . .

As the legality of national notes was debated, the government returned to the gold standard in an effort to stabilize prices after the inflationary Civil War years. To do this, Congress had to remove greenbacks from circulation.

The reduction in the money supply initiated a recession and began one of the most intense and dramatic struggles in the history of American money—a struggle, in essence, about how our money should be valued.



A greenbacker cartoon of the 1870s shows a gold-nosed government octopus strangling labor, farmers, and small business. The greenbackers fought gold payment on bonds.

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The lines were clearly drawn. On the one side, the hard-money advocates, generally representing big business and banking groups of large Eastern cities, favored the gold standard. On the other side, the easy-money advocates, generally representing small business and small town and farming groups of the West, favored easier money and credit and abandoning the gold standard.

The controversy continued intermittently for 30 years. Advocates of easy money organized their own political party, the Greenback Party, and entered candidates in three presidential campaigns. However, their lack of success can be attributed at least partially to national sentiment favoring gold.

When the government removed paper money after the war, prices fell, eventually coming fairly close to pre-war levels. Congress then passed the Resumption Act, directing the Treasury to redeem any paper money presented for redemption after January 1, 1879. The money was to be redeemed in coin, at pre-Civil War gold parity, With the greenback a lost cause, the easy-money bloc turned to silver coins as a means of increasing the money supply.

And Maybe Silver. . .

Silver coins had not been circulated widely since 1834 because the official ratio of gold to silver was 16 to 1. Since the price of silver was higher in the open market than at the Mint, mine owners sold their silver to bullion dealers.

In an effort to align the law with reality, Congress ended the coinage of silver dollars in 1873, although it authorized a new silver coin—the trade dollar—which had a higher silver content and was intended for foreign commerce. At about the same time, however, miners discovered large new deposits of silver. Silver miners and others in the easy money bloc interested in an expanded money supply decried the "Crime of '73" and demanded a return to the old silver dollar. Joining the crusade were farmers and other debtors who would have benefitted from an expanded money supply.

Responding to the outcry Congress passed the Bland-Allison Act in 1878, which authorized the Treasury to purchase silver and issue silver certificates for the first time. The easy money bloc achieved another victory in 1890 when Congress passed the Sherman Silver Purchase Act, which required to Treasury to purchase 4.4 million ounces

The $1000 Treasury note of 1890 was called the "Grand Watermelon" because of the ornate zeros on the reverse side.

of silver each month using a legal tender Treasury note. To make the notes more acceptable, the Treasury redeemed them in gold. There were immediate problems. People exchanged the notes for gold and hoarded the gold or used it to purchase imports.

The Treasury's gold holdings fell rapidly, severely decreasing the money supply and setting off the Panic of 1893 and a sharp recession. Congress quickly repealed the Sherman Silver Purchase Act, ending the panic, but the recession lasted for years.

. . . But Finally Gold

The easy-money bloc's attacks on gold continued throughout the recession, culminating in the presidential election of 1896. The hard-money advocate William McKinley defeated easy-money advocate William Jennings Bryan, famous for his "Cross of Gold" speech at the Democratic National Convention. Bryan's losses in 1896 and again in 1900 marked the end of the free silver movement. Fulfilling his campaign promise, McKinley signed the Gold Standard Act in 1900. The act officially ended bimetallism and established gold as the single legal standard.

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While the gold standard provided a means of limiting the money supply, the economy was marked by periodic financial panics, inflations, and recessions through much of the nineteenth century. It became clear that the gold standard was sometimes too inflexible. We needed a monetary authority that would be disciplined enough to increase or decrease the flow of money based on the needs of the economy.

Federal Reserve and Elastic Currency

In response to the problems in our economy and financial system, Congress in 1913 created the Federal Reserve System. The Federal Reserve, our nation's central bank, is a network of 12 regional Reserve Banks supervised by a Board of Governors in Washington, D.C.

Congress gave the Fed responsibility for providing an elastic currency, that is, a currency that could increase and decrease to accommodate the needs of the economy. To expand the currency, the central bank made loans to banks and provided them currency, Federal Reserve notes, to meet their customers' demands. These loans helped prevent runs on banks and kept many banks from closing. Congress tried to prevent

The $10,000 Federal Reserve note was first issued in 1918 with a portrait of Salmon P. Chase, Secretary of the Treasury under President Lincoln.

overissuance by requiring that Federal Reserve notes be backed by gold and certain kinds of securities representing loans to manufacturers and farmers.

For the first time in our history we had a monetary authority that could influence the money supply to the benefit of the economy. The amount of money in the economy no longer would be determined

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solely by the supply of gold or wartime needs. With the Federal Reserve System, Congress created a viable alternative to gold.

Gradually we relied more and more on the Fed's discretionary authority and eventually eliminated the gold backing of money. The initial break came with World War I.

The Break with Gold

In 1914, shortly after President Woodrow Wilson signed the Federal Reserve Act, World War I broke out, severing international relations. Countries refused to ship gold to one another in payment for international debt. Gold tended to accumulate in the treasury vaults of the world, particularly in the safe haven of the United States.

Because of this war-time breakdown, gold gradually lost much of its monetary importance. Gold certificates and gold coins still circulated, but much of our gold was concentrated in the Treasury's vaults. Monetary gold became a reserve backing for the money supply and a means of settling international transactions.

The final break with gold, which came in the early 1930s during Franklin Roosevelt's administration, created the need for new criteria and standards to replace gold's automatic operation. Congress had already laid this groundwork two decades before with the Federal Reserve Act.

From its inception, the Fed had been charged by Congress not only with providing an elastic currency, but also with maintaining stability in our financial system and promoting a healthy economy. With the break from gold, the Federal Reserve assumed the primary responsibility for influencing the money supply to encourage a healthy, growing economy.

This responsibility requires the Fed to maintain the long-term purchasing power of money as well as foster high employment and economic growth. In the long run, the Federal Reserve seeks to achieve reasonable price stability, which in turn, sets the stage for a healthy, growing economy. However,

the Federal Reserve must also consider the performance of the economy in the short and intermediate terms, and avoid the boom and bust cycles that plagued the U.S. economy in the late 1800s.

Faced with all these goals simultaneously, the Fed seeks an acceptable balance among them. In practice it is not always clear what is in the best short-term and long-term interest of the economy. Difficult decisions have to be made. While the gold standard provided little flexibility, the Fed operates with discretion. This discretion allows it to respond to the changing needs of the economy to foster a healthy, growing economy with price stability.

The Story Continues...

Since the founding of our country, we have moved from a decentralized to a fairly centralized monetary system. We started with gold and silver coins as the chief medium of exchange, supplemented by colonial currencies and bank notes, and moved to a system of uniform national currency with legal tender status.

As we have seen, the Constitution and gold have played extremely important roles in this evolution. From the early republic until well into this century, the Constitution, and how we interpreted it, greatly influenced the federal government's involvement in monetary affairs.

And for many years, gold played an important role as a regulator of the money supply. But after many decades of debate on how best to maintain a healthy financial system, we created the Federal Reserve System in the early years of this century. We did this because we realized that gold and the gold standard were no longer adequate regulators of money's value in our modern and complex economy. The Federal Reserve provides a more flexible means of regulating the money supply, thus helping to ensure a healthy, growing economy with price stability.

Money Matters—The American Experience with Money is one of a series of essays adapted from articles written in *On Reserve*, a newsletter for economic educators published by the Federal Reserve Bank of Chicago. The original articles were written by Keith Feiler. Tom Gittings and Ken Goldsmith prepared the revision.

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Money Matters

Classroom Questions for Money Matters

- American History Questions & Activities
- American Government Questions & Activities
- Answers to questions on the cover
- Money Matters Booklet
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- Ordering Information

American History

Content Questions & Activities

1. What characteristics were desired by those who argued for centralized and decentralized banking systems? (page 3)
2. What seven characteristics made gold and silver good choices as monetary commodities early in our history? (page 5)
3. What was the original ratio of gold to silver in the early American money supply? What other ratios were used during periods of bimetallism? (pages 5 and 6)
4. On what aspect of the Constitution did Thomas Jefferson and Alexander Hamilton base their opinions regarding the federal government's authority to charter banks? (page 6)
5. Which states instituted activities that led to the first Supreme Court case regarding constitutionality of the central bank? (page 8)
6. What characteristics of United States Notes, issued by act of Congress in 1862, set them apart from previous national currencies? (page 11)

7. How were the Bland-Allison Act of 1878 and the Sherman Silver Purchase Act in 1890, similar? What effect did the latter have on the national economy? (page 15)

8. When did the final break with gold come for the United States? Who was President at the time? (page 17)

Application Questions & Activities

1. Have students suggest why earlier forms of commodity money (wampum, beaver pelts, tobacco, etc.) might not have met the seven basic standards or characteristics of money.

Durability	Things like tobacco aren't very durable, they don't stand up to handling well.
Recognizable	Certain amount of familiarity with some commodities is necessary to confirm they are what they're supposed to be.
Storability	Foodstuffs can decay and deteriorate.
Movable	Large quantities of some commodities can be bulky and hard to handle.
Dividable	Items like beaver pelts don't break down easily.
Standardized	Commodities can vary widely in quality and therefore value.
Scarcity	What's scarce in one part of the country may be plentiful in others.

2. What was the key part of Chief Justice John Marshall's reasoning in finding for the Bank of the U.S. in McCulloch vs. Maryland? How was this important to future central bank debates?

   The recognition of "implied powers" that are "necessary and proper" for carrying out operations. These concepts were key not only to further cases regarding money and central banking, but for a wide array of other Court decisions.

3. Which three post-civil war court cases cleared the way for issuance of United States Notes and when were they decided? What was the key

issue in each case? How did these cases help to strengthen the national government?

Veazie Bank vs. Fenno - the right to tax state banknotes in competition with national currency;

Hepburn vs. Griswold - the legal tender status of U.S. notes, particularly for contracts entered before the notes were introduced;

Julliard vs. Greenman - the right to issue paper currency and declare it legal tender in time of peace as well as of war.

All of them concentrated power in the hands of Congress and the Federal government over state government.

4. What effect did the withdrawal of greenbacks have on the post-Civil War economy? Explain.

Withdrawal of greenbacks reduced prices to pre-war levels but also caused a recession. A reduced money supply stifles expansion through scarcity and, ultimately high real interest rates. The dollars used to pay back debt are worth more in purchasing power than the dollars that were borrowed in the first place.

5. Hypothesize why the various interests lined up the way they did on the question of a gold-backed dollar? What incentives would each group have to stake the position that they took?

The bankers and large business interests were in favor of stable prices and values or even declining prices with increasing values for the money. This would mean loans would be repaid with dollars worth more than those loaned in the first place and product prices would be paid with dollars worth more than those used to buy the resources. Small business and farmers, as borrowers, were in favor of rising prices, falling dollar values and a little inflation to eat away at dollar values of loans.

6. Considering the effect of silver resumption in the late 19th century, what was it that William Jennings Bryant was ultimately advocating in his "cross of gold" speech?

Ultimately, Bryant was in favor of rising prices for farmers and wages for workers via the inflation mechanism.

7. What problems accompanied the McKinley administration's decision to

return to gold? How would these problems affect the "common citizen"?

Falling prices and recession. There was continued downward pressure on wages from general price deflation and high unemployment. This made for a hard economic environment.

8. Explain what is meant by an "elastic currency" and how it can impact the economy in times of financial crisis.

An elastic currency is one that can increase its supply in hard financial times (such as panics) and then decrease when normalcy returns. This allows the money supply to keep pace with economic growth and provide price stability rather than inflation or deflation.

American Government

Content Questions & Activities

1. What were the two principle positions taken on the issue of banking by those charged with designing the Constitution? How was the debate resolved? (page 3)

2. What actions brought about the first constitutional test of the nation's central bank? (page 8)

3. What phrase or phrases formed the heart of the Supreme Court decision that resolved the first test of the central bank? (page 8)

Application Questions & Activities

1. How did the issue of "express vs. implied powers" manifest itself in the debate about the nation's financial system?

These represent the basic views about banking and money. The express powers forces said national and central banks were not allowed for because they were not expressly provided for by the Constitution. The implied powers advocates turned to the "necessary and proper" clause of the Constitution, stating that national banks and central banks were necessary and proper to the conduct of the nation's business.

2. How did Andrew Jackson's view of the Second Bank of the United States reflect the populist tradition in American politics?

Jackson and his populist supporters did not trust anything big...business, government, or finance, and felt that small government best suited the size of the nation.

3. What circumstances surrounding Hepburn vs. Griswold promoted a constitutional crisis for the Grant administration? How was the crisis resolved and what constitutional precedent was part of the resolution?

The original Hepburn vs. Griswold was not heard by a full court (only 7 sitting members at the time) and was decided against national bank notes by a 4-3 vote. Grant appointed two more justices and the case was heard again (which is allowed) and the new decision was 5-4 in favor of bank notes. Importantly, the second hearing of the case validated the "necessary and proper" clause and implied powers in supporting the Federal government's contention.

Answers to questions on the cover

- Is our money backed by gold? page 2
- Does our Constitution authorize national currency? pages 3 and 8
- Why does the Fed issue currency? pages 16 and 18

Ordering Information

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